Comments on Draft Membership Rules for CASE: Part I

The Egypt Capital Markets Development Project

CHEMONICS INTERNATIONAL INC.

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The Cairo and Alexandria Stock Exchanges (CASE) provided the Capital Markets Development (CMD) project with a draft, dated May 27, 1998, of Chapter V of the rules of CASE, entitled “Exchange Membership” (references hereafter will be to the “Rules” or a “Rule" set forth in this draft). CASE has asked CMD to review and comment on the six major areas covered by the Rules. This first report of our comments will discuss the Rules in the following four major areas.

1. Admission to Membership: This consists of Rule 5.1, Class of Exchange Members; Rule 5.3 Membership and Associated Person; Rule 5.4 Obligation of Exchange Members and Associated Persons; Rule 5.5 Restrictions on Admittance to or Continuation in Membership and Association; Rule 5.6 Examinations; Rule 5.8 Procedures for Admission as a Member or as an Associated Person of a Member; Rule 5.9 Procedures for Discontinuation of Exchange Membership or Association with a Member; Rule 5.10 Voluntary Termination of Membership; Rule 5.38 Changes in Members' Systems, Practices and Relationships; and Rule 5.40 Branch Offices;

2. Financial Responsibility, Net Capital and Record-Keeping. This consists of Rule 5.12 Books and Records; Rule 5.14 Records of Written Complaints; Rule 5.14 [sic] Disclosure of Financial Condition; Rule 5.21 Difference or Error Account; Rule 5.32 Records; Rule 5.35 Annual Audits and Periodic Questionnaires; Rule 5.39 Supervision of Members Because of Financial Condition; Rule 5.43 Minimum Capital Rule; Rule 5.45 Financial Exposure to a Single Client; Rule 5.46 Financial Exposure to a Single Security; and Rule 5.47 Early Warning Levels Procedures, Levels 2 and 1;

3. Members' Business Structure, Organization and Personnel. This consists of Rule 5.15 Internal Controls; Rule 5.38 Changes in Members' Systems, Practices and Relationships; Rule 5.40 Branch Offices; and Rule 5.41 Members' Other Interests; and

4. Rights of CASE to Inspect and Require Reports from Members and to Enforce the Rules of CASE and the Capital Market Authority (the "CMA"). This consists of Rule 5.13 Furnishing of Records; Rule 5.30 Original Records of Members; Rule 5.31 Records and Reports Available at the Request of the Exchange; Rule 5.36 Special Examinations; and Rule 5.37 Expenses of Audits.

In a supplemental report to be provided within the next few weeks, we will cover the remaining two areas—Members’ Conduct of Business and Advertising and Communications with the Public.

We have also reviewed the “Comments on Membership Rules” dated 19 May 1999, and the “Notes for Discussion regarding the Membership Rules” dated 6 May 1999 prepared by staff members of CASE. We are also and generally in agreement with those comments, as some of these proposed rules are either inconsistent with current practices or are the responsibility of other infrastructure institutions. We therefore have not reviewed or commented , unless

CASE wishes us to do so, upon Chapter VII (Non-Member Brokers) and upon Rules dealing with the following: access participants; unlisted securities; settlement failure; discretionary and managed accounts and portfolio managers; securities lending and borrowing; short selling; and clearing members.

Admission to Membership

There is an inconsistency between the Rules in this category and the Executive Regulations of the Capital Market Law (the "Executive Regulations"). Article 120 of Chapter 3 of the Executive Regulations establish seven categories of companies which are Securities Intermediation Companies, including securities brokerage. Several requirements for licensing as a securities intermediation company are set forth. Among these are minimum capital (Article 125), must be in corporate or similar form (Article 128) and the contents of the application for licensing (Article 135).

The Executive Regulations contemplate a certain structure for a licensed brokerage company. It must have a board of directors and directors (Article 135). It must have an auditor (Article 128). It is contemplated that the licensee will have managers and employees (Article 217). If it is a stock exchange member it will have representatives who may execute transactions for it on the exchange (Articles 88 and 89).

The Membership Rules do not contain any provisions prohibiting fraud, misstatements or omissions of material facts in connection with an application or communication to the CASE in connection with the application for, or maintenance of, membership or association with a member. The Rules appear to require all employees of a member to register as an associated person. Executive Regulation Article 218 requires a brokerage company to maintain a record of its structural organization including the duties and responsibilities of each manager and employee representing the company in dealings with the public. It would appear that, at the least, these together with persons authorized to represent the firm on CASE are the persons who should be registered with the CASE. Further, no rule authorizes CASE to investigate in connection with membership or associated person application.

Rule 5.8, purporting to establish procedures for admission as a member or associated person, is cumbersome and does not clearly describe all that is or should be required. Rather than trying to do all this in one rule we will suggest a combination of rules. First, we will discuss each of the rules comprising the Membership Admission Rules.

Rule 5.1 establishes 3 classes of CASE membership -- clearing members, correspondent members, and access participant members. We do not discuss Chapter VII, Non-Member Brokers, and any rules relating to clearing. We are also aware that the Egyptian Capital Market Association ("ECMA") is being established as a self-regulatory organization for the securities industry. It would therefore appear that, should ECMA become a broker-dealer association for the “over-the-counter” market, as is NASD in the U.S., there should be only one class of CASE membership which should be available to licensed securities intermediation companies that are securities brokers.

Rule 5.3 establishes two categories of registration -- the member and the associated persons, being any person employed by a firm and not otherwise granted an exemption from registration. This is not consistent with the regulatory registration contemplated by the Executive Regulations. As is contemplated, there should be a licensing for securities

brokerage firms licensed as securities intermediation companies. There should be a category of registration for persons who will represent the broker for trading on CASE. There should be a second registration category for persons who will manage the firm, particularly those who will supervise, directly or indirectly, those persons who have contact with the public and with others securities intermediation companies, and finally there should be a third registration category for those who will have contact with the public and with other securities intermediation companies.

Rule 5.4 spells out what a firm, seeking CASE membership, and a person, seeking to be associated with such a firm, must agree to. This is not necessary. The CASE Rules should specify that a member firm and a registered person are obligated to comply with the rules of CASE, the Executive Regulations and the Capital Market Law. Other conditions, as discussed below, may be reflected in the membership or registration agreement signed by the member firm or registered associated person.

Rule 5.5 sets forth various requirements that a member firm must comply with in order to maintain its membership. As such, it is not inappropriate.

Rule 5.6 requires membership applicants and associated persons to take and pass proficiency examinations administered by ECMA. The member firm is a corporate entity and so is not capable of taking a proficiency examination. Proficiency examinations should be prescribed, as discussed below, for the categories of persons required to be registered -- the representative authorized to execute orders on CASE, managers, and persons in contact with the public or other securities intermediation firms.

Rule 5.6 also requires associated persons to supply CASE with information as requested by CASE and to permit examination of the person's books and records. This should be part of the agreement that an associated person will execute, as a condition of approval of their registration. If necessary to do so, it may also be included in a rule.

Rule 5.8 is unduly complicated. This may be because it tries to cover several issues -- membership on CASE, association with a member, the process for application, review of the application and denial or grant of membership. We will discuss below our suggestions in this area.

Rules 5.9 and 5.10 for the voluntary termination of membership or associated person status or for involuntary termination if the member or associated person fails to meet qualification requirements are confusing. Anyone should be allowed to withdraw from membership or association if they wish, absent a situation where the withdrawal is in anticipation of a disciplinary proceeding. This second issue could be dealt with in a rule giving CASE continuing jurisdiction over a firm or person for some period of time after withdrawal. As to the second case, termination or a lesser sanction should be based upon a breach of a law, rule or regulation and after an opportunity for a fair hearing to determine if there has been a breach and the appropriate sanction therefor. If the only sanction for a violation is termination, many violations will go unpunished because of the severity of the sanction.

Rule 5.38 gives CASE the authority to require any member or affiliated company to change any book-keeping, record-keeping system or course of handling securities or money and to change any financial arrangement or business association as the CASE may disapprove of and to comply with any requirement of the CASE. This is a rather broad and draconian

authority. The CASE should have the right to sanction a member or associated person for violation of its rules, the Executive Regulations and the Capital Market Law. Those regulations should provide for minimum books and records, handling of money and securities transactions (while securities are handled by bookkeepers), financial arrangements, but only limited to the adequacy of capital and operations and that persons who have violated the law should not be associated with a firm (see Articles 89 and 135). Beyond that, CASE should not have the power to direct how a member or associated person will conduct their business.

Further this is a reactive rule. In other words, unless CASE learns of a situation of which it disapproves nothing will be done. Instead, member firms should be required to report certain changes in their business, capital, control and conduct and obtain CASE approval thereof in advance. This would also be consistent with Articles 89 and 135 which impose standards of satisfactory capital, management, methods for doing business, etc., as a condition of licensing or representation of a firm on the exchange.

Rule 5.40 prohibits establishing branch offices without prior CASE approval, and CASE may condition such approval on such terms as it may decide. Requiring advance approval from CASE to establish a branch office is appropriate. However, there should be definite standards set forth in the Rule against which such request should be measured. These standards should be that the applicant has sufficient capital, record-keeping, trade execution and supervisory systems that the branch can operate efficiently, in compliance with the CASE rules, the Executive Regulations and the Capital Market Law, and the member can adequately supervise the activities of the new office.

Recommendations

We suggest a certain rationalization and clarification of the membership rules. We would require that no firm could directly execute trades on CASE if it is not a member firm and each of its associated persons who are required to be registered is registered in the proper category. Another rule should prohibit fraud, omissions or misstatements of facts in any application or communication in the registration or application process.[1] Another rule would authorize CASE, or ECMA, if appropriate, to conduct such investigation and inquiry as it deems appropriate to confirm or supplement the information furnished by an applicant for membership or to be an associated person. There should be rules for application and approval of membership and rules for the registration of the three categories of associated persons: representatives for order execution on CASE, managers, and supervisors of persons with contact with the public or other securities intermediation companies, and persons who have direct contact with the public and with other securities intermediation companies.

The membership application process should be clarified so that both applicants and CASE personnel will have clear standards against which to measure the application. Consistent with Article 135, we would recommend that the membership application contain, at a minimum, the following:

[1] It would be prudent to prohibit fraud, misstatements or omissions of material fact in any report to or communication with CASE.

1. Identify the applicant. This should include its name, address, telephone number, form of business, licensing from the CMA and in the Commercial Register, shareholders and their shareholdings, other capital contributors, others with an economic interest in the applicant, the personnel who will be registered as associated persons and their background.

2. A business plan for the applicant. This should set forth all material aspects of its business, a trial or "pro forma" balance sheet, supporting schedules and net capital computation, a monthly projection of income and expenses for the first 12 months, a description of the business to be engaged in, how customers and suppliers will be obtained, a description of the facilities out of which it will conduct its business and any other activities that may be engaged in by the applicant.

3. Applications for each person who will come within the definition of associated person -- representative to execute trades on CASE, manager of those with contact with the public and other securities intermediation companies, and persons with direct contact with the public and other securities intermediation companies.

4. A description of its record-keeping system and its system of financial controls.

5. A description of its supervisory system and internal regulations (see Articles 217, 218 and 219) as well as a copy of its compliance or comparable manual.

6. A description of the nature and source of its capital, identifying all capital contributors and others with an economic or beneficial interest, other than that arising out of being an employee, in the applicant, as well as sources of additional capital within the first 12 months of operation, if necessary.

Once a completed application is submitted, CASE should have a reasonable time to review it and request additional or supplemental information to satisfy itself that the applicant is satisfactorily organized, capitalized and licensed, that its personnel are appropriately registered, that its plans and systems are reasonably designed to achieve their stated goals in compliance with all applicable laws, rules and regulations, and that there are no statutory or regulatory impediments to being a member. This process should be timed -- e.g., a review period of 90 days, which may be extended by each new request for information an additional 30 days from the date such information is supplied by the applicant. There should be a cut off time -- e.g. 180 days from filing a completed application, to approve or deny a request, with an automatic denial if requested information has not been supplied.

Appropriately completed applications with any additional or supplemental information that show compliance with the law, rules and regulations, a likelihood of continued compliance, reasonable capital, satisfactory record-keeping, financial and supervisory systems and a prudent business plan should be approved. As part of the approval the member would enter into an agreement with CASE as to compliance with all applicable laws, rules and regulations, CASE's right of examination and inquiry, and right to impose sanction for violations. In addition the membership agreement would impose limits upon the member so that it could only conduct the business set forth in its business plan. Any changes or modifications would require prior CASE approval.

To support this latter provision, we would recommend a separate rule requiring a member to obtain prior CASE approval for any material change in its business. This would include any acquisition or disposition of more than a 25% economic interest in its business or the business of a third party -- e.g., share sales or issuance, any mergers or acquisitions involving the member, any new lines of business, dropping of existing lines or other material change in business or operations.

Opening a new branch office would require CASE approval in advance. Approval would be granted upon demonstration that the member had sufficient capital, net capital, operating systems, record-keeping systems, supervisory systems, trade execution and reporting systems and experienced and knowledgeable personnel to operate the new branch office in a manner consistent with applicable laws, rules and regulations.

Separate rules would govern the registration of each of the three identified categories of associated persons. Members would be prohibited from employing or compensating an associated person in any of the specified categories who was not registered. Any person performing the functions, duties or services of a category of associated person would be prohibited from doing so unless registered in that category. Registration would require a complete identification of that person, their education and business history (see Articles 89 and 135). Registration would be accomplished by filing an application containing the required information and satisfactorily passing a competency examination for that category as administered by CASE or ECMA. Upon a finding of passing the required test and no reason for disqualification from association based upon the information furnished by the applicant and any inquiry conducted by either CASE or ECMA, associated person status would be approved for that person.

We note that there is no proposal for a continuing education rule. This rule could require associated persons to take courses annually in the areas in which their member firm operates and a periodic tutorial in applicable laws, rules and regulations.

Financial Responsibility, Net Capital and Record-Keeping

No business can reasonably expect to succeed if it does not maintain adequate records of its financial transactions. The Executive Regulations do not specify any particular books or records that a securities brokerage company must maintain. However, they clearly contemplate that such records will be maintained (Article 227) and that these records will be audited as they require an acknowledgement from the company's auditor as part of the company's licensing (Article 128). Further, securities brokerage firms are required to send clients, on request, financial data based on the recent authenticated financial statements of the brokerage firm (Article 227).

The Executive Regulations also contemplate financial responsibility and net capital rules. Article 125 requires a minimum capital of LE250, 000 of which one-fourth must be paid up for a securities brokerage license. Article 126 provides that the maximum value of operations of a securities intermediation company must be in line with its capital. Article 216 requires a securities brokerage company to have the needed solvency to perform its activities and to ensure the fulfillment of its obligations. The Regulations do not specifically set forth a net capital rule or other measure of financial responsibility. However, it would be consistent with the concepts of self-regulation for the CASE to have a measure of financial responsibility.

Rules 5.12 and 5.32 require CASE members to maintain books and records. Logically, Rule 5.12 should be included in Rule 5.32. Members should be required to maintain, at a minimum, prescribed records and to make all of its books and records available to CASE for inspection or copying at any time. Rule 5.32 should be two rules. One should specify the required books and records. The other should state the periods these and other records and documents received or created by a member must be retained. (We note that Rule 5.32 refers to trades for the account of member and securities held by or for a member.) Rule 5.32 omits several records that should be required. These include: borrowings by a member and any collateral therefor; personnel information for each employee and associated person of the member showing the information required to be filed for registration of such person; and a computation of the member's net capital, which must be made at least monthly. Rule 5.32 or a new Rule should require that all of a broker's books and records be maintained on a current and accurate basis. Provisions, whether in Rule 5.32 or a new Rule, should be added to allow the use of book-keeping or record-keeping services to prepare the member's books and records and granting CASE the right to inspect such records at these service bureaus.

In addition to the specified records, it would be prudent to require the maintenance of additional records. Among these would be: check books, bank statements, cancelled checks and cash reconciliation; all bills receivable or payable -- paid or unpaid; all communications received and sent in the course of its business; all agreements entered into by the member relating to its business; records supporting the member's audited financial statements; all guarantees issued by or to the member; and all powers of attorney that the member or any of its associated persons have. This proposal is broader than Rule 5.14 (the first 5.14) which calls for records of all written customer complaints. Article 219 requires the firm to keep a file of all customer complaints. This would appear to include all written, oral and electronically transmitted complaints. In this regard, and consistent with Article 219, CASE may wish to adopt a rule requiring periodic reports to it of all complaints received by a member firm, broken out by categories, and a notation as to the date and nature of the firm's response. Customer complaints are a good indicator of troubled areas in a firm, and could guide CASE as to areas calling for further examination.

Rule 5.21 requires a member to maintain a difference or error account for securities not received due to errors and to buy in or borrow such securities within 30 business days. This exposes a member to substantial risk for an extended period. We suggest that all errors, and or differences that a member has, should be recorded and either be bought in promptly or charged, at their current market value, against the member's net capital.

Rule 5.35 requires a periodic audit of a firm done by a firm listed on a panel of auditors specified by the CASE Chairman. The audit is to be performed in accordance with CASE rules, but Rule 5.35 does not specify such standards. Rule 5.35 is not consistent with Article 128, which does not limit who may be the auditor of the company. We would suggest that the requirement be that a firm must have an annual audit of its financial statements done by an auditor that is an independent certified public accountant who is duly licensed and in good standing. To maintain the integrity of the process, the firm and the auditor should be required to enter into a contract to perform the audit at least six months in advance of the audit date. The audit should be conducted in accordance with generally accepted auditing standards. This will allow the accounting industry to develop its own standards of what is an appropriate audit guide and what should be included. The results of the audit, including a balance sheet, income and expense statement and source and application of funds, as well as

a computation of net capital and aggregate indebtedness for the broker should be filed with CASE and possibly the CMA within 60 days of the audit date. The accountants should be required to furnish the broker, with a copy to CASE and to the CMA, a letter describing any material inadequacies in the books, records, record-keeping, and supervisory systems of the broker uncovered in the course of the audit. Consistent with Article 227 and the second Rule 5.14, the broker should prepare a summary of the audited financial statements, which it would make available to requesting customers. Good business practices will likely cause all brokers to send these summaries to their clients.

Rule 5.35 also contemplates that upon CASE's request members will submit periodic financial questionnaires. This is an after the fact situation. Clearly, CASE should have the right, at any time and from time to time, to require that brokers file financial information with it. In addition, all brokers should be required to submit, at least quarterly, financial reports showing their balance sheet, income and expense, and net capital and aggregate indebtedness. These quarterly reports need not be audited, although CASE should have the right to inspect the member, among other reasons, to confirm their accuracy. These quarterly reports would serve as the early warning signals of potential financial problems at a member firm. CASE would be able to monitor these firms in advance of any serious problems so that mitigation could be accomplished. Rule 5.44 requires a monthly statement of minimum capital to CASE for each month by the 20 of the following month. This is helpful in the case of members approaching financial difficulties.

Rule 5.43 establishes a minimum capital for members as a LE amount and as 5% of aggregate debt for certain members. Rule 5.45 limits a firm's exposure to any one single client to no more than 300% of the member's last audited shareholders' funds. Rule 5.46 limits a member's exposure to any one security to no more than 20% of paid up capital of the listed company concerned or 500% of the member's last audited shareholder funds. On their face these rules appear prudential. However, the result is to limit the activities of a member firm. For example, a member firm that is part of a family of financial services intermediaries could be impeded in servicing its several affiliates by the 300% limit. Similarly, a firm performing investment banking services for a company could be impaired in acquiring securities for that company for resale as part of a distribution by the limitations of 20% of the client's capital and 500% of its capital. Rather, these issues should be addressed through the net capital rule discussed below by using additional haircuts for a customer's debit balance in excess of a certain percentage of the firm's net capital and, where a member is permitted to own securities, a haircut for securities positions in excess of certain percentages of the firm's net capital.

Rule 5.47 imposes limits on a member's activities and requires additional reporting of financial information to CASE if a member's net capital falls to between 125% and 110% of minimum net capital or the member's condition is not otherwise satisfactory to the CASE due to operational or late reporting problems. Members with less than 110% of the minimum net capital are required to file monthly financial reports, weekly capital reports and prepare a plan approved by CASE to resolve this problem.

It is prudent for CASE to have early warning trigger points for members experiencing financial and operational problems. However, the levels chosen in Rule 5.47 are so low that a member experiencing these problems will likely be in violation of the rules by the time the reports are filed. In the U.S. if a firm's net capital falls to less than 150% of the minimum

required or its ratio of aggregate indebtedness to net capital reaches 2/3 of the maximum permitted, serious reporting requirements are imposed and the firm is prohibited from expanding its business. If progress towards resolving the capital problem is not forthcoming or net capital falls to less than 125% of the required minimum, the regulatory authorities can direct the firm to begin a self-liquidation. In addition, capital withdrawals in the next 6 months that would result in or would continue any of the foregoing conditions are prohibited. In no event should a member in violation of the net capital rule be allowed to continue doing business. This exposes both its customers and other securities intermediation companies to material risk of loss upon the default of the troubled firm as well as violates Article 216.

Recommendations

A net capital rule is intended to assure that a securities firm has sufficient liquid assets or assets that can be readily converted into cash so as to meet all of its financial obligations, including those to customers and other securities intermediation companies, in a timely manner. Such a rule should apply to all licensed securities brokers, regardless of size or nature of business. Net capital is assets minus liabilities, reduced by illiquid assets, unsecured receivables from customers or customer receivables in excess of the underlying assets held for the customer, and even accounts and further reduced by a "haircut" or percentage of current market value of securities held, where permitted, by the firm. This assures that a member has a pool of assets that can be readily converted into cash. To assure the adequacy of this pool, the rule usually requires that net capital be at least a specified minimum amount, which can be varied based on a member’s line of business, and bear a certain relationship to "aggregate indebtedness". Aggregate indebtedness is all unsecured liabilities, and maximum ratio of net capital to aggregate indebtedness is 6 and 2/3%.

We previously discussed the early warning systems and limits they impose upon a broker in financial difficulty. A ratio of aggregate indebtedness to net capital of 10:1 (net capital is 10% of aggregate indebtedness) or net capital less than 150% of the minimum trips off the early warning reporting requirements and limits a firm’s expansion.

Rule 5.43 would give credit for computing net capital to several illiquid assets. These include a percentage of the member's premises, land and building of the member at their value at a forced sale as determined by professional appraisal. This is contrary to the principle that the net capital rule is liquidity standard.

Rule 5.43 would also allow capital credit for indebtedness of the member the payment of which is subordinated to the payment of all other liabilities on the member. This is a prudent item for inclusion in net capital. However, it should not be allowed to be so much as to undermine the member's financial condition. The subordinated indebtedness included in net capital should not exceed 70% of net capital, except for subordinated indebtedness owed to equity holders of the firm which have a stated term of at least 3 years and at least 12 months to maturity.

Member's Business Structure, Organization and Personnel

Article 128 requires securities brokers to be incorporated. Article 135 sets standards for members of the board of directors and directors. Chapter 6, Provisions Regulating Portfolio Management Companies and Brokerage Companies and particularly Section 2, Internal

Regulations and Supervisory Systems, of the Executive Regulations set a framework for this category. Article 217 requires a written compliance manual, with a copy to CMA, setting forth the work system and rules to be followed by mangers and employees. Article 218 requires a structural organization that sets forth the duties and responsibilities of each manger and employee representing the broker to third parties.

We have previously discussed Rule 5.38 and our suggestion for a rule requiring prior CASE approval for material changes in ownership, control or business activities of a member firm. We have also discussed Rule 5.40 dealing with branch offices and our suggested revision to that rule.

Rule 5.15 requires members to adopt and maintain internal procedures to assure that directors and employees act in conformity with applicable laws, rules and regulations. This is a positive statement, but lacks clarity. We made the recommendation that as part of the application process an applicant must submit its compliance manual, which meets the requirements of Articles 217, 218, 219 and 220. It is tempting to propose a model or standard form of compliance manual. However, brokers have such varied lines of business and different ways of conducting their business that such a model would either be restrictive or not applicable in many contexts. It is better to set forth a general standard of the laws and rules to be covered in a compliance manual and allow each brokerage firm the flexibility to design a supervisory system and compliance manual that is suitable to it. Further, more than a compliance manual is required. The brokers must maintain a supervisory system that evidences their efforts to apply the compliance manual's directives in their business activities and to demonstrate that managers have reviewed the activities of their subordinates to assure compliance with all applicable laws and rules. As part of such a system, every person must be supervised by another as to compliance matters, even the chief executives of a broker.

Rule 5.16 and several other rules inappropriately use the word “partner.” No member can have a partner—they must all be joint-stock companies. Therefore, they can only have shareholders.

Rule 5.41 would require all members (assuming it means associated persons) who have interests other than in dealing securities to declare such interests to CASE. CASE may condition or require cessation of such continued interests. Article 89 would make such a rule applicable to member firm’s representatives to CASE. However, so long as an associated person is engaged full time in the securities industry and is in compliance with all applicable laws, rules and regulations, we see no reason why they should not be allowed to or limited in engaging in other businesses outside of the securities industry. The rule also prohibits a member from being a director, shareholder or debenture holder in another firm in the stock brokering business. There are good reasons to limit a person associated with one brokerage firm from being associated with another brokerage firm, except where such association is to provide ministerial or financial and accounting services. On the other hand, good arguments can be made, and the National Association of Securities Dealers in U.S. allows dual association where both firms are aware of it and receive records of the person's activities at the other firm. Further, this rule should not operate to impair an associated person from investing in a publicly held company that is a brokerage firm or is part of a complex that includes a brokerage firm.

Right of CASE to Inspect and Require Reports from Members and to Enforce the Rules of CASE and CMA

Rule 5.13 contains three parts. The first part requires a member to supply CASE with copies of financial information filed with CASE. If the information is required to be filed with CASE what is the need for this provision? It also requires a member to furnish records, files or financial information regarding transactions executed on or through CASE. If, as we proposed earlier in this memorandum, CASE has the right to inspect members at any time and to require reports from members, what is the need for this provision? If the intent is to require that reports be submitted electronically or in electronic format, that can be the subject of a separate rule or it can be included in the rule regarding the right to require reports. The final part of the first paragraph is a right to inspect to verify information. The right of inspection is already discussed and proposed in the rule relating to books and records.

The second part gives up to 20 business days to reply to CASE requests for trading data. This is inconsistent with the need for speedy investigations before the recollections of the parties grow cold. There should be a duty to promptly respond to CASE requests for information -- whether financial, books and records or trading data. A rule should make the failure to respond promptly to a CASE request a violation, in and of itself. What time is reasonably required to respond to a request is, to a large extent, dependent upon the data requested -- how current are the records/data requested, how complex is the request, and how voluminous is the data requested. Therefore, it is difficult to adopt a rule setting out a specified time frame for reply to a request, regardless of the nature of the request. The addition at the end of this second paragraph that data may be supplied in such form and on such schedule as CASE may request contradicts the first part. Both should be replaced with a requirement for prompt and complete responses that do not omit or misstate any material fact requested.

The third paragraph allows CASE to supply information to other regulatory authorities. CMA as a matter of law should have the right to inspect CASE and to obtain copies of its records. Giving such authority to the CMA would cover this issue. As regards other governmental authorities the operative law for such authority should deal with this issue rather than making CASE a quasi policeman for other governmental authorities.

Rule 5.30 authorizes CASE, at any time, to inspect members' records and prohibits removal of records from Egypt without CASE consent. The right of inspection has already been dealt with. The removal of records would also be dealt with in the rule we have proposed requiring that books and records and other documents (written or electronic) sent or received by a member be retained by the member for specified periods. The removal of an original record from Egypt so long as duplicates were retained within the country should not affect the jurisdiction or investigation activities of CASE, or, for that matter, the CMA.

Rule 5.31 requires members to maintain, but without any guidance as to how long, and to submit all information requested by CASE in such form as CASE may request. We have already discussed the need for a record retention rule. Our earlier discussion of Rules 5.12 and 5.32 covers the balance of this rule. In sum, it is a duplication of other rules.

Rule 5.36 authorizes CASE to select a member from the panel of auditors, created under Rule 5.35 for the purpose of auditing member firms, to conduct a special or general

examination of a member's financial affairs. Rule 5.37 imposes the cost of such audit upon the member. We have already expressed our views on Rule 5.35. Rules 5.36 and 5.37 raise several questions going to the issue of what is self-regulation. Who should be responsible for the examination of a member's compliance with financial responsibility, books and records and conduct rules? Who should bear the costs of such examinations?

A main argument in favor of self -regulation is that the industry has the knowledge and skill to identify areas of concern in the conduct of industry members. This rule could be interpreted as indicating that CASE does not have the staff possessing such knowledge and skill, and this would be an indictment of CASE. The fact that CASE has to retain third parties to conduct examinations of the financial affairs of a member suggests that it lacks expertise in this area. The second issue is the cost of such examinations. Is it reasonable, much less fair, to require a member experiencing financial distress to be burdened with the costs of examinations of its financial condition ordered by CASE? If the member can not afford the cost of an examination, will CASE staff direct a member of the panel of auditors to conduct such an examination? This is particularly relevant where the panel member may look to CASE for payment because the CASE member is unable to pay. One of the main arguments for self-regulation is that the industry bears the costs of its regulation. If the industry, through CASE, does not have the funds and staff to conduct examinations what is the basis for such an argument? It is the practice in other countries for each of the self regulatory organizations to impose charges upon its members, as a whole, and upon third parties using its services (e.g. trade quotations and trade reporting). These fees generate the funds to hire a staff of examiners and to pay the costs of their examinations of the member firms. We recommend such practice to CASE.